

City of San Diego

AUDIT REPORT

***PERFORMANCE AUDIT OF THE SAN DIEGO
HOUSING COMMISSION – PART II***

July 29, 2009

**Office of the City Auditor
Eduardo Luna, CIA, CGFM, City Auditor**

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THE CITY OF SAN DIEGO

July 29, 2009

Honorable Mayor, City Council, and Audit Committee Members
City of San Diego, California

Attached is our report regarding our audit of the Affordable Housing Fund. This is the second and final report related to the performance audit of the San Diego Housing Commission. A separate report was issued previously to discuss San Diego Housing Commission's management and business practices and its relationship with the City of San Diego. Management's response to our audit report can be found attached. The audit staff responsible for this audit report was John Teevan, Tiffany Chung, and Kyle Elser.

We would like to thank the San Diego Housing Commission staff, as well as representatives from other City departments for their assistance and cooperation during this audit. We also would like to thank officials from other municipalities and other government agencies that participated in our audit. All of their valuable time and efforts spent on providing us information is greatly appreciated.

Respectfully submitted,

Eduardo Luna
City Auditor

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EXECUTIVE SUMMARY

The San Diego Housing Commission (SDHC) was established by the City of San Diego City Council in 1979 and is charged with helping to bridge the gap between the high cost of housing in the City of San Diego and the high percentage of low wage earners, helping to correct an imbalance that threatens the stability of our work force. Based on our performance audit, we found that the Housing Commission faces unique challenges related to the accounting for the Affordable Housing Fund, comprised of the Housing Trust Fund and Inclusionary Housing Fund, which needs to be improved and may not have been fully funded. We found that:

- Housing Trust Fund-related commercial linkage fees are outdated, substantially lower than comparable cities, and were not adjusted as required by the municipal code resulting in an estimated underfunding of \$2.79 million for fiscal years 2006 through 2008;
- SDHC receipt of direct payments from developers is inconsistent with the municipal code;
- The City and SDHC reported, but did not reconcile, different fee revenue amounts;
- SDHC Inclusionary Housing Fund policies and regulations are inadequate or poorly defined;
- The City's Inclusionary Affordable Housing Regulations need to be updated; and,
- City and SDHC reporting, monitoring, and disbursements of Affordable Housing Fund revenues are fragmented and disjointed.

INTRODUCTION

The San Diego Housing Commission (SDHC) is an organization established by the City of San Diego City Council (City Council) in 1979 which is charged with helping to bridge the gap between the high cost of housing in the City of San Diego and the high percentage of low wage earners, helping to correct an imbalance that threatens the stability of our work force. The organization operates under the direction of a Board of Commissioners appointed by the Mayor and confirmed by City Council. This report focuses on the accounting and reporting related to the Affordable Housing Fund. This is the second and final report related to the performance audit of the San Diego Housing Commission. A separate report was issued at an earlier date to discuss San Diego Housing Commission's management and business practices and its relationship with the City of San Diego.

The City Auditor's Office thanks SDHC and City management and staff for giving their time, information, insight and cooperation during the audit process.

BACKGROUND

Established by the City Council in 1979, SDHC helps house more than 75,000 low-income San Diegans each year through a variety of programs. These include owning and managing approximately 1,800 housing units, providing rental assistance for more than 12,000 families and individuals, offering financial assistance for qualifying first-time homebuyers, and rendering both financial and technical assistance to low-income households whose older homes need rehabilitation.

In addition, SDHC collaborates with nearly 11,000 businesses and investors to provide affordable housing in return for tax credits and other incentives. The agency also works with nonprofit organizations to help them achieve the housing components of their programs. As a provider of innovative job training and educational programs for residents, SDHC not only helps house families, but provides learning opportunities for them so they can become self-sufficient and free of government assistance.

The Affordable Housing Fund

The Affordable Housing Fund (AHF) is a permanent, annually renewable source of funds to help meet the housing assistance needs of the City's very low, low and median income households. The City Council expressed this intent in San Diego Municipal Code (SDMC) §98.0501 - §98.0518. In general, the AHF's purposes are to:

- Meet a portion of the need for housing affordable to households with very low to median incomes;
- Leverage every one dollar of City funds with two dollars of non-City subsidy capital funds;
- Support the Balanced Communities Policy by fostering a mix of family incomes in projects assisted by the Fund and dispersing affordable housing projects throughout the City;
- Preserve and maintain renter and ownership of affordable housing; and,
- Encourage private sector activities that advance these goals.

The City of San Diego Annual Plan (Annual Plan) implements the City Council's intent by adopting an annual overall strategy for use of AHF moneys. Development of this Annual Plan is guided by SDHC's annual budget process, current Business Plan, and the Consolidated Annual Performance and Evaluation Report (CAPER), which is required by HUD. The flexibility of the AHF allows revenues to be spent on local needs, including transitional housing programs, housing rehabilitation loans and grants, and assists first-time home buyers to purchase homes in the City.

The AHF contains two main revenue accounts: the Housing Trust Fund (HTF) account and the Inclusionary Housing Fund (IHF) account. Revenues generated from commercial linkage fees, fees assessed on non-residential developments on a square foot basis, are deposited into the HTF. The City Council expressed this intent in SDMC §98.0501 - §98.0518. The IHF contains revenues generated from "in lieu" fees¹ paid by contractors who decide not to set aside 10 percent of their residential homes at affordable rates for modest income families, as required by SDMC §142.1301 - §142.1312.

SDHC generally receives payments (in the form of a paper bank check) from the City for each quarterly reporting period for AHF fee revenues collected. Prior to the latter part of fiscal year 2007, the City sent two quarterly checks, one for IHF fee revenues and one for HTF fee revenues. Starting with the April 2007 payment, the City had made it a standard practice of sending one quarterly check to SDHC which includes fee revenues collected for both HTF and IHF. Effective January 1, 2009, this practice has been discontinued and the City has reinstated separate payments for the HTF and IHF.

The following City departments have been identified as being involved in the different steps of the AHF processes, including their roles and responsibilities:

¹ The amount of the in lieu fee shall be the sum of the applicable per square foot charge multiplied by the aggregate gross floor area of all of the units within the development.

- *Development Services Department (DSD)*: In lieu fees related to the IHF are assessed by DSD before applications are approved. All fees for the AHF as a whole are collected at DSD for SDHC at the time when building permits are issued to non-residential (for the HTF) and residential (for the IHF) developers;
- *Facilities Financing (City Planning & Community Investment Department)*: Assesses HTF fees before applications are approved;
- *Treasurer's Office*: Receives deposits from DSD and records deposits by fund name (e.g. HTF, IHF) and subaccount (i.e. by Community Plan Area in the case of IHF fee revenues);
- *Comptroller's Office*: Reviews AHF funding balances and then prepares disbursements and fund reporting to SDHC.

Appendices B and C which were both prepared by city audit staff have been included to outline the flow of processes related to fee collections, reporting and disbursements for the HTF and IHF, respectively.

AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY

At the request of the Mayor and the Chair of the City's Audit Committee, the City Auditor included a performance audit of the San Diego Housing Commission (SDHC) as part of the City Auditor's Fiscal Year 2009 Audit Work Plan. According to the City Auditor's Citywide Risk Assessment completed in July 2008, SDHC ranked 69 out of a possible 458 by the City Auditor as posing a risk to the City based on factors including budget and staff size.

To accomplish our objectives related to SDHC-related affordable housing funding sources, we performed the following audit procedures:

- Reviewed pertinent regulations, laws, and policies related to SDHC programs, operations and related activities;
- Identified, collected, and analyzed financial information and reports related to SDHC operations;
- Reviewed minutes of the Board of Commissioners and San Diego Housing Authority for topics discussed and / or actions taken;
- Interviewed SDHC management and other personnel as well as other City staff related to programs, operations and related reporting;
- Evaluated administrative policies and procedures related to SDHC business practices and programs;
- Reviewed recent financial statement and single audits performed by external auditors;
- Contacted and surveyed housing authorities and commissions from other municipalities and agencies to compare governance, organizational structure, purpose and other comparable information.

We evaluated internal controls related to the audit objectives. Our conclusions on the effectiveness of these controls are detailed within the following audit results.

We focused our audit plan on five SDHC areas of responsibility, including executive compensation, governance, the Affordable Housing Fund, CDBG funding and the New Development projects (related to the HUD Public Housing Disposition). As disclosed earlier, this report focuses solely on the area of the Affordable Housing Fund. Additional findings and recommendations for our performance audit of SDHC can be viewed in the previously released SDHC report. We limited our review of SDHC services primarily to fiscal years 2006 through 2008. Current year financial information was reviewed to gain perspective on the current operating and reporting practices of SDHC.

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate

evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT RESULTS

Affordable Housing Fund Accounting Issues Need Immediate Attention

We found that the accounting for the Affordable Housing Fund (AHF), comprised of the Housing Trust Fund (HTF) and Inclusionary Housing Fund (IHF), needs to be improved and may not have been fully funded. We found the following:

- HTF-related commercial linkage fees are outdated, substantially lower than comparable cities, and were not adjusted as required by the municipal code resulting in an estimated underfunding of \$2.79 million for fiscal years 2006 through 2008;
- SDHC receipt of direct payments from developers is inconsistent with the municipal code;
- The City and SDHC reported, but did not reconcile, different fee revenue amounts;
- SDHC IHF policies and regulations are inadequate or poorly defined;
- The City's Inclusionary Affordable Housing Regulations need to be updated; and,
- City and SDHC reporting, monitoring, and disbursements of AHF revenues are fragmented and disjointed.

The above audit observations have had a significant negative financial impact on the SDHC mission to provide quality housing opportunities to improve the lives of those in need and the SDHC vision for an affordable home for every San Diegan. The underfunding of the AHF restricts SDHC's capacity to provide more quality housing to the City's most vulnerable population and limits the agency's ability to leverage AHF funds with other government and community resources to create more housing and economic opportunities for residents and builders alike.

Housing Trust Fund Commercial Linkage Fees Are Outdated and Substantially Lower Than Comparable Cities

Our review of commercial linkage fees charged by the City revealed that the City's commercial linkage fee schedule has not been updated since 1996. Furthermore, we found that the current development fee schedule published by the City's Planning and Community Investment Department has the same outdated fee schedule for commercial linkage (City Planning and Community Investment Facilities Financing, 2008). As a result, the City has underfunded the HTF due to the ongoing use of outdated housing impact fees, resulting in unrealized revenue. We estimated the 1996 fees in the SDMC would be increased by approximately 41% when

updated through 2008, representing approximately \$2.79 million in fees otherwise unrealized from or not charged to developers between fiscal years 2006 through 2008².

Revisions to Appendix A of SDMC §98.0618 indicates: “The fees set forth in Appendix A **shall be revised effective March 1 of each year** by the percentage increase or decrease in the building cost Index of the Cost Indices for Twenty Cities published by M.C. McGraw–Hill, Inc. or its successor for the twelve–month period ending January 1 of each year. The Commission, in consultation with the City Engineer shall prepare a recommendation to the Council for such revision on an annual basis.” Appendix A of SDMC §98.0618 includes the following rates as shown in Table 1. These rates were made effective July 1, 1996:

Table 1:
Housing Trust Fund Commercial Linkage Fee, SDMC §98.0618, Appendix A

Type of Use	Fee/Building Square Foot
Office	\$1.06
Hotel	\$0.64
Research and Development	\$0.80
Retail	\$0.64
Manufacturing	\$0.64
Warehouse	\$0.27

As it relates to the City Engineer’s role in providing HTF fee adjustment consultation to SDHC, we found that the City’s Development Service Department does not coordinate with SDHC to adjust HTF fees based on the building cost “Index of the Cost Indices for Twenty Cities” published by M.C. McGraw–Hill, Inc. as directed by the SDMC.

Moreover, the SDMC does not accurately document the responsibility for the collection and maintenance of the HTF fees by the Comptroller in a specific subaccount after collection by the City. This could result in ineffective processing of transactions since these processes are not formally documented as noted separately.

SDHC and City personnel have not actively coordinated the update of these fees as prescribed by the municipal code on a regular basis. The most recent documented attempt by SDHC to update these linkage fees occurred in May 2005. At that time, SDHC personnel presented recommendations on an information only basis to the Land Use & Housing Committee (LU&H)

² We noted that there was litigation, *Building Industry Association of San Diego County, Inc., v. City of San Diego*, Superior Court Case No. GIC 817064, which was settled in 2006, which dealt with the inclusionary “in lieu” fees charged by the City. As a result, it would not appear to be directly related to the Housing Trust Fund linkage fees.

of the San Diego City Council, and additional analyses were requested from members of LU&H. The requested analyses were completed, but no subsequent opportunities were made available to discuss this issue further at LU&H.³ We found no evidence that City personnel followed up on this issue, and, as a result, these fees were not updated.

San Diego Commercial Linkage Fees are Low Compared to Other Municipal Jurisdictions

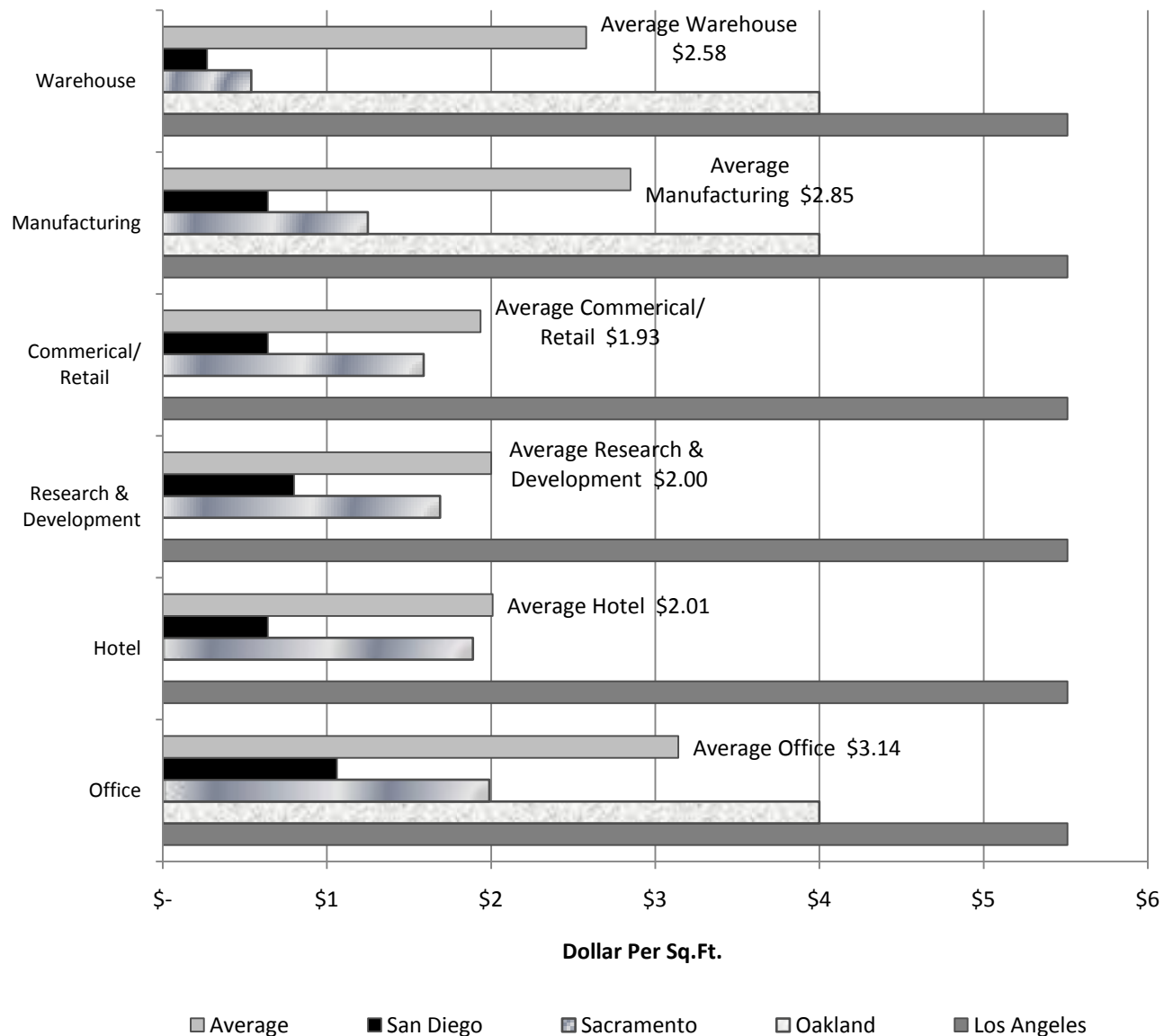
From our analysis of commercial linkage fees assessed by a sample of comparable cities⁴ in California (see Figure 1), we found that the City of San Diego's linkage fees for all use types were substantially lower, in some cases up to 195% lower than the second lowest fee in our list of sample cities.

Figure 1 is a chart which summarizes the comparative linkage fee data considered.

³ Per the Housing Commission Board report HCR05-62 dated June 29, 2005, SDHC staff indicated that "Representatives of the Building Industry Association (BIA) suggested the city should continue to utilize the Twenty Cities [Indices], also known as the Engineering News-Record (ENR), cited in the 1990 Housing Trust Fund ordinance. As stated earlier, the Planning Commission also recommends the use of the ENR."

⁴ The cities included in the sample possessed similar population demographics and economic characteristics to the City of San Diego.

Figure 1:
Comparison of San Diego Linkage Fees to Comparable Cities by Building Type



Source: Auditor prepared ⁵

⁵ The City of San Francisco was excluded from these analyses since their fees were determined to be far in excess of the other cities reviewed, including the City of Los Angeles (Los Angeles), and would statistically skew the results. The City of San Jose was also excluded since they do not assess these types of fees. Furthermore, the amounts included for Los Angeles only represents the “Central City West Project Area”, since this is the only project area in Los Angeles with this type of linkage fee assessed on non-residential developers. Finally, the amounts included for the City of Sacramento represent the general fees for that city and do not include the fees applied to the project area of North Natomas.

Recommendations:

- 1) SDHC, in collaboration with City Administration, should perform a review of the Housing Impact Fee schedule, and assess reasonableness and consistency with SDMC §98.0618. The fees should be updated through 2009 to be consistent with the SDMC. If the updates are not practical or feasible, the communication of the current intent to request updates through City Council should be clearly documented and retained by both the City Administration and SDHC;
- 2) SDHC, in collaboration with City Administration, should develop and implement procedures so that Housing Impact Fee updates are recalculated March 1 of each year by the appropriate percentage increase or decrease as indicated in the SDMC and prepare a recommendation to the City Council for such revision on an annual basis. If the updates are not accepted or processed by the City Council, the annual communication of the requested updates through City Council should be clearly documented and retained. If the SDMC will not be followed, then it should be amended to reflect the current fee expectations in relation to the Housing Trust Fund, a change that would require City Council action to amend the SDMC;
- 3) City Administration should facilitate the update of the SDMC to accurately reflect the current process for the collection and maintenance of the Housing Trust Fund fees by the Comptroller in a specific subaccount after collection by the City.

The Receipt of Direct Payments to the Housing Commission from Developers is Inconsistent with the Municipal Code

Historically, SDHC has accepted direct payments of IHF fees from developers. Although no policy was found that directly prohibits this practice, SDHC's collection of IHF fees directly from developers can be interpreted as a violation of SDMC §98.0502. Based on the information provided by SDHC, 28 payments totaling \$1,939,557 in IHF transactions were received directly from developers between fiscal years 2006 and 2008. These include 24 payments totaling \$1,792,122 (and a refund of \$12,800) in fiscal year 2006, two payments totaling \$58,331 in fiscal year 2007 and two payments totaling \$89,104 in fiscal year 2008. Furthermore, Coastal Affordable Housing Replacement Program fees (Coastal) transactions were also processed through the IHF accounts maintained by both the City and SDHC. The \$12,800 Coastal fee incorrectly paid to the City was transferred out in fiscal year 2006 and two Coastal payments totaling \$188,000 that were incorrectly paid to the City in fiscal year 2006 were subsequently transferred out in fiscal year 2007.

SDMC §98.0502(a) states “The Affordable Housing Fund shall consist of funds derived from the commercial development linkage fees **paid to the City** pursuant to Chapter 9, Division 6, Article 8 of the SDMC; revenues from the Transient Occupancy Tax as provided in Section 35.0128 of the SDMC; funds derived from in lieu fees **paid to the City** pursuant to Chapter 14, Article 2, Division 13; revenues received from the use of a shared-equity program pursuant to Section

142.1309(e) of the SDMC; and any other appropriations as determined from time to time by legislative action of the City Council.”

Further, SDMC §98.0502(a) also states that “The Affordable Housing Fund **shall be administered by** the San Diego Housing Commission pursuant to the provisions of this Division, the appropriation ordinances and Council policies applicable thereto.”

The only apparent SDHC policy related to either the IHF or HTF, jointly representing the AHF, is “Commission Responsibilities Related to the Housing Trust Fund” policy number PO300.501 which indicates in Section 2.1 that “The Commission shall be responsible for oversight and support of the Housing Trust Fund and its Board of Trustees in accordance with the provisions of this policy, Ordinance Number 0-17454, and Resolution Number R-275565.” Of note, both City Ordinance 0-17454 and Resolution R-275565 establish the current language in Article 8 Division 5 of the SDMC pertaining to the San Diego Housing Trust Fund. This policy does not include any specific reference to direct payments.

Allowing developers to make payments directly to the SDHC bypasses the City’s internal controls and related processes, and can result in additional ongoing differences in reporting between the SDHC and City recorded amounts. Since SDHC is the City’s primary provider of affordable housing, it is imperative that the City be able to account for affordable housing funds and related services to ensure that SDHC complies with the SDMC and affordable housing regulations. Direct payments of AHF to SDHC by developers creates a difficulty for the City to accurately account for how much City fee revenue is collected and, ultimately, how much affordable housing and related services the people of San Diego should anticipate receiving.

The receipt of payments by SDHC directly from developers has resulted from the inconsistent application of the expectation of the SDMC for fees to be paid to the City and not to SDHC.

Recommendations:

- 4) SDHC personnel should immediately discontinue the practice of receiving payments directly from developers. Any future attempted payments of that type should be directed to the City DSD;
- 5) SDHC should develop additional policy and departmental guidance to detail the process and documentation requirements in relation to the Affordable Housing Fund (inclusive of both the Housing Trust Fund and Inclusionary Housing Fund), which would include reference to the proper handling of direct payments from developers and the timely reconciliation of Affordable Housing Fund funds to include comparing City-provided periodic reporting to actual payments received on a quarterly or annual basis;
- 6) The SDHC Policy “Commission Responsibilities Related to the Housing Trust Fund” (PO300.501) should be updated as needed to accurately reflect the current process including

a prohibition against the receipt of direct payments from developers and the reporting relationship with the City, as applicable;

The City and SDHC Report Different Amounts of Fee Revenues

Neither the City nor SDHC have reconciled AHF revenues. To assess the accuracy of AHF revenue collection, remittance amounts and process, we attempted to reconcile the IHF and HTF fee revenue collections by the City with the fee revenues SDHC reported receiving from the City. We found a net discrepancy of approximately \$1.3 million between those amounts reported by the City and SDHC between fiscal years 2006 and 2008. The IHF fee discrepancies we observed are summarized below in Table 2:

Table 2:
Summary Comparison of City and SDHC Inclusionary Housing Fund In Lieu Fee Reporting

<u>Fiscal Year</u>	<u>Total Per City</u>	<u>Total Per SDHC</u>	<u>Difference</u>
2006	\$6,896,254	\$8,589,727	\$1,693,473
2007	\$4,656,105	\$4,549,880	(\$ 106,225)
2008	<u>\$3,451,263</u>	<u>\$3,202,676</u>	<u>(\$ 248,587)</u>
Totals	<u>\$15,003,622</u>	<u>\$16,342,283</u>	<u>\$1,338,661</u>

Note: Fiscal year totals do not include interest earned on the IHF fee revenue accounts. The standard practice is for interest to be included in disbursements from the City to SDHC.

Source: Auditor generated from City Comptroller Simpler financial data and SDHC fee reporting.

The “Total per SDHC” amounts include payments received directly from developers to SDHC. In order to properly estimate the amount of difference between City and SDHC, the net overall direct payment for the three fiscal years – \$1,738,757 – was deducted from the total for SDHC, resulting in an overall difference of \$400,096 (City reporting in excess of SDHC amounts received). This remaining difference includes the following:

- 1) a payment of \$12,800 paid out directly by SDHC in fiscal year 2006 from this fund for a refund of Coastal fees (unrelated to the IHF) incorrectly received by the City;
- 2) payments totaling \$188,000 paid out directly by SDHC in fiscal year 2007 from this fund for refunds of Coastal fees (unrelated to the IHF) of \$188,000 incorrectly received in fiscal year 2006 by the City.

In comparison, the commercial linkage fees accounted for within the HTF exhibited a difference of \$3,373 for the \$8,991,518 (or .03%) in excess received by SDHC from the City for the same period.

SDMC §98.0503(b) indicates that “The City’s Annual Appropriation Ordinance shall provide for the transfer of designated funds to the Affordable Housing Fund. Transfers shall be made quarterly or upon direction of the City Manager.”

The “Internal Controls Procedures” prepared by the SDHC finance department indicates that “accounting controls are a set of procedures designed to promote and protect effective and efficient financial management practices. Following these procedures will significantly increase the likelihood that financial information is reliable.”

Moreover, the elements of a comprehensive framework of internal control include, but are not limited to, the following: 1) design, implementation and maintenance of control-related policies and procedures; 2) effective communication of information and ongoing monitoring of the effectiveness of control-related policies and procedures; 3) resolution of any potential problems identified (Gauthier, 2005, p.382).

Inadequately performed reconciliations of financial information can result in inappropriate disbursements and related reporting and, subsequently, ineffective or inappropriate business decisions. Moreover, inaccurate financial information makes it increasingly challenging to identify specific areas of weakness and to uphold accountability, especially when many parties are involved.

These effects may be mitigated by having formal processes and procedures in place that give guidance to the current and best practice of preparing financial disbursements and reports. To date, however, complete processes and procedures have not been developed and implemented for the timely reconciliation of AHF funding amounts at SDHC and the City.

Recommendation:

- 7) City Administration and SDHC personnel should reconcile the current differences in historical reported amounts for Inclusionary Housing Fund funding. If warranted, disbursement to or from SDHC or the City should be made to settle any outstanding payment discrepancies. Procedures should be established to perform this reconciliation at least annually.

SDHC Policies Related to the Affordable Housing Fund Need to be Improved

As noted earlier, SDHC has one formalized policy that relates to AHF: PO300.501. This policy focuses solely on HTF; SDHC does not have a formal policy on IHF.

Two key requirements from the SDMC⁶ that are not included in PO300.501 are statements about SDHC's responsibility to account for and report separately the HTF in the San Diego Housing Commission's annual audited financial report and that such funds shall be audited for compliance with the AHF Ordinances and any related policies and regulations. SDHC has not been in compliance with either of these requirements to date.

Of note, an essential element of a comprehensive framework of internal control is monitoring, which should include the verification by management that policies and procedures have been "updated to adequately address new challenges identified as the result of the government's ongoing risk-assessment process." (Gauthier, 2005, p.387) As such, policies and procedures should be formalized to document expectations related to both the IHF **and** the HTF.

Undocumented policies and related internal controls and processes can result in unclear roles and responsibilities and ineffective business transactions.

SDHC policies have not been established in relation to the IHF. Also, the responsibility to account for and report separately on the HTF on the audited financial statements as well as fund compliance auditing has not been included in PO300.501. Moreover, these requirements have not been actively fulfilled in the preparation of SDHC's annual audited financial statements.

Recommendation:

- 8) A new SDHC policy should be drafted, approved and implemented to accurately reflect the SDHC "Responsibilities Related to the Inclusionary Housing Fund" (similar to PO300.501 and including any updates thereof);
- 9) The existing policy PO300.501 (and the new Inclusionary Housing Fund policy recommended separately) should be updated to include the requirements to account for and report separately both the Inclusionary Housing Fund and the Housing Trust Fund in the audited financial statements as well as the audit for compliance with the AHF Ordinances and any related policies and regulations;

⁶ SDMC §98.0515(b) indicates that SDHC "shall maintain and report within their accounts a separate Affordable Housing Fund and the subsidy funds of the Housing Trust Fund, the Inclusionary Housing Fund, and any other required related subsidiary funds for all related financing transferred from the City and any related income. Such funds shall be accounted for and reported separately on the San Diego Housing Commission's annual audited financial report, and such funds shall be audited for compliance with the Affordable Housing Fund Ordinance, Inclusionary Housing Ordinance, and related policies and regulations."

- 10) The requirements to account for and report separately both the Inclusionary Housing Fund and the Housing Trust Fund in the audited financial statements as well as the audit for compliance with the AHF Ordinances and any related policies and regulations should be implemented for the fiscal year 2009 and future annual audits.

The City's Inclusionary Affordable Housing Regulations Need to be Updated

Our audit revealed that, although the IHF fees have been updated regularly consistent with SDMC §142.1310(e), the SDMC has not been updated to reflect the changes in fees. Instead, the updated fees are published in the publically available “Information Regarding Inclusionary Housing” newsletter by DSD (City Development Services Department, 2008). However, reference to that newsletter or the City department responsible for that update (or any other related reference documentation) is not included in the above SDMC.

Another essential element of a comprehensive framework of internal control is communication which “can take various forms, from policy memos and formally documented procedures, to highly informal oral updates.” Furthermore, “it is very important that governments maintain open lines of communication with appropriate outside parties” (Gauthier, 2005, p.386).

Developers or other interested parties may not be adequately informed of the current rates due to the lack of appropriate, timely referential material available in the SDMC.

SDHC and City Administration have not actively coordinated the update of the SDMC to reflect the updated fees and / or a reference to how the new fees can be obtained. It should also be noted that the municipal code is ambiguous about where officially updated fees can be found and the entity ultimately responsible for ensuring that updates are conducted and appropriately recorded.

Recommendation:

- 11) SDHC and City Administration should review SDMC §142.1310(e) and have the applicable SDMC sections updated to reflect the current fees or make reference to the source document or department for the updated fees, a change that would require City Council action.

Controls over the Transfer of Affordable Housing Funds Can Be Improved

As illustrated in Appendices B and C, our audit revealed that the reporting and disbursements made in relation to collected AHF fee revenues are fragmented and unaligned between various City departments, including the Comptroller, Facilities Financing and DSD. Each of these departments submit fee revenue information to SDHC that differ in fee type, amount of fee revenues collected, and timeframe in which fee revenues were collected. Facilities Financing and DSD generate quarterly HTF and IHF fee revenue reports, respectively. The Comptroller produces periodic AHF fee revenue reports which are used to determine the total AHF revenue to remit to SDHC. The quarterly and periodic reporting directly to SDHC from each department is performed independently. The different fee types, fee revenue amounts, and collection timeframes reported by each department creates fragmented and unaligned communication about HTF, IHF, and AHF, collectively.

For instance, instead of forwarding quarterly reports to the Comptroller for reconciliation between available revenue and subsequent disbursement to SDHC, Facilities Financing and DSD send quarterly information to SDHC. Independent of that reporting, and on occasion prompted or otherwise urged by inquiries or communications directly from SDHC, the Comptroller reviews the funding in and prepares a consolidated transfer from the HTF and IHF to SDHC.

Furthermore, there is a lack of clear process documentation including procedures and communication standards related to AHF transfers from the City to SDHC. Our review of these transfers shows that the City does not remit AHF revenues to SDHC on a consistent quarterly basis⁷, nor did the City process these transfers in a timely manner. Between fiscal year 2006 and 2008, the City remitted 15 transfers to SDHC for AHF fee revenues collected. Of the 15 transfers reviewed, 14 transfers were sent to SDHC late⁸ and six of the 14 late transfers were paid over 25 business days late. Based on our discussion with SDHC personnel and review of documentation, transfers have often been facilitated by repeated reminders from SDHC.

The U.S. General Accounting Office (1999) internal control standards explain that appropriate documentation of transactions and internal control requires “internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals and may be in paper or electronic form. All documentation and records should be properly managed and maintained” (p.15).

⁷ SDMC §98.0503(b) indicates “Transfers shall be made quarterly or upon direction of the City Manager.”

⁸ Our audit assumed that the City would remit transfers to SDHC within 10 business days after the period end date noted on supporting documentation obtained from the Comptroller’s Office.

In general, the elements of a comprehensive framework of internal control includes, but is not limited to, the design, implementation and maintenance of control-related policies and procedures, effective communication of information and ongoing monitoring of the effectiveness of control-related policies and procedures, as well as the resolution of any potential problems identified (Gauthier, 2005, p.382).

City departments involved in this process have historically operated independently of one another without consideration for the unification or streamlining of processes, resulting in less than efficient or effective communications, reporting and disbursements to SDHC. Mutually agreed-upon goals and expectations for the timing of the transfers from the AHF funds have not been clearly established and formalized. Furthermore, process and internal control documentation related to AHF funding and reporting, including timing of transfers, have not been formalized.

Disjointed processes and communications can result in untimely transfers and related reporting. This could also lead to ineffective business decisions being made. Additionally, poor communication among city departments creates redundancies that can become costly to the City both financially and in terms of public trust.

Recommendation:

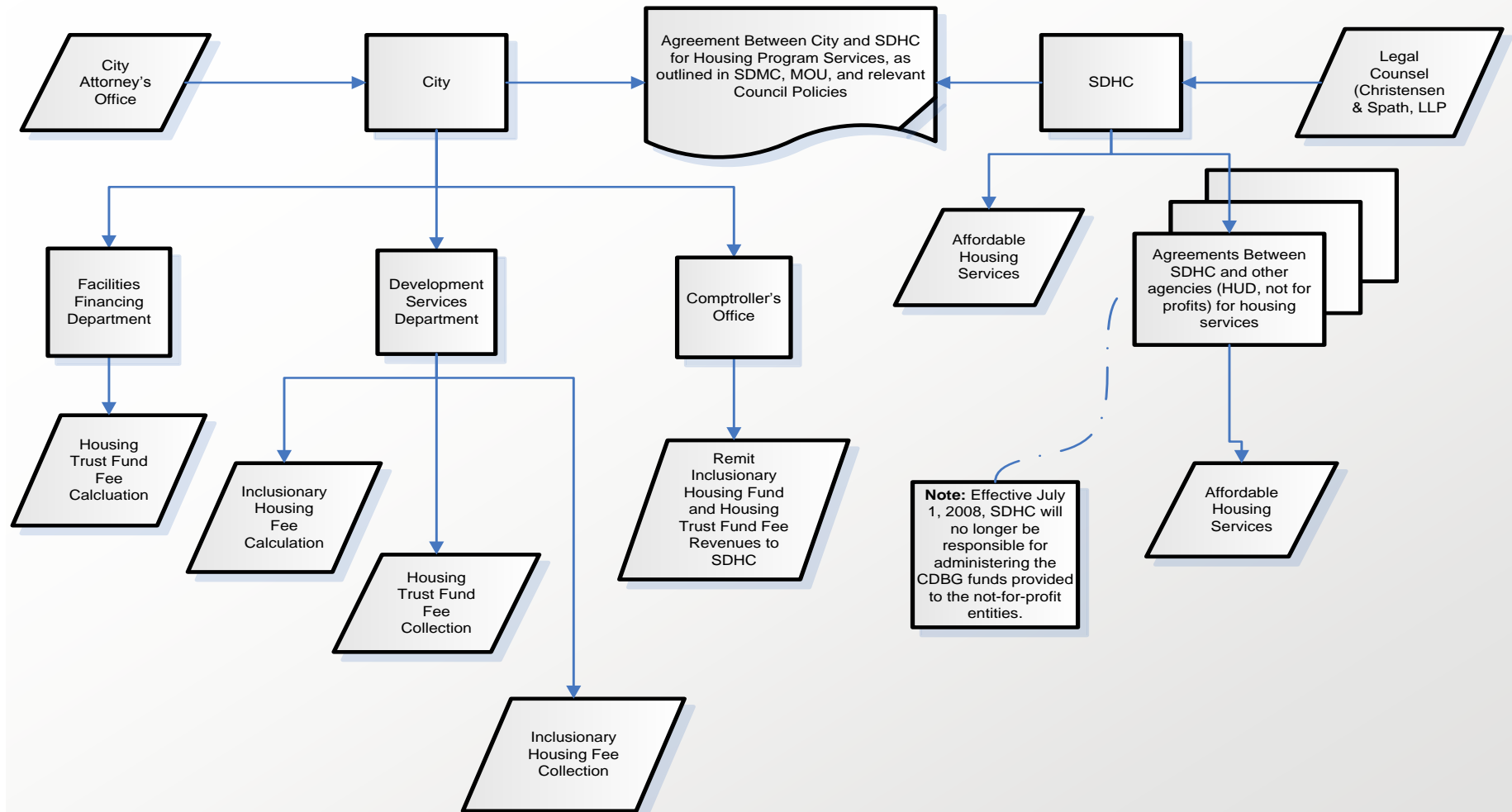
- 12) City Administration should draft, approve and implement departmental guidelines (across multiple departments as needed) to accurately identify and document the process roles and responsibilities for City departments, including the Treasurer, Comptroller, Facilities Financing and Development Services Department (DSD) in Affordable Housing Fund - related processes. These processes should include the reporting of quarterly and annual Housing Trust Fund and Inclusionary Housing Fund activity by Facilities Financing and DSD to SDHC and the Comptroller. The Comptroller should reconcile fund levels and make disbursements based upon mutually agreed upon amounts from that reporting on a consistent and timely basis.

REFERENCES

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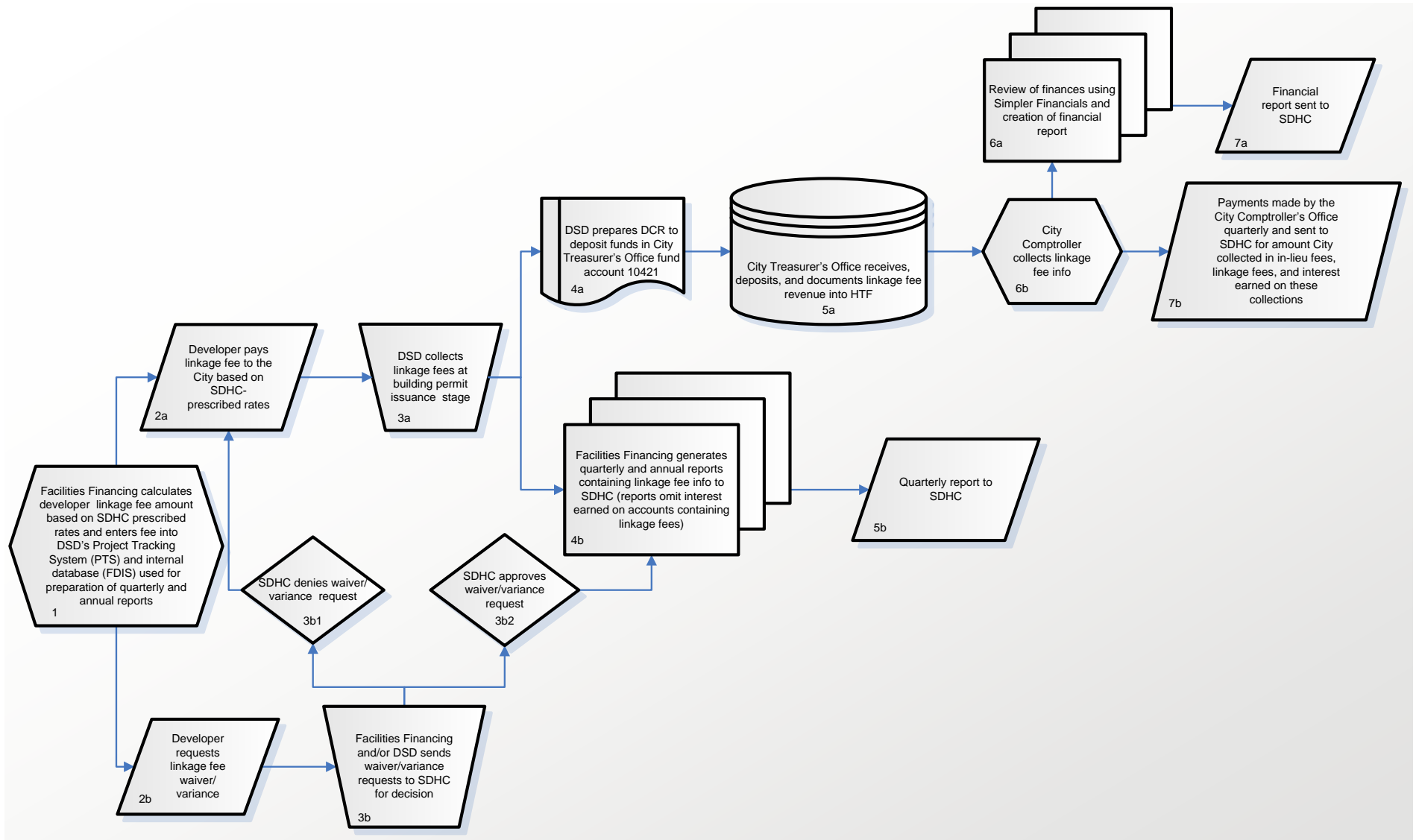
APPENDICES

Appendix A: City of San Diego and SDHC Nexus for Housing Activities

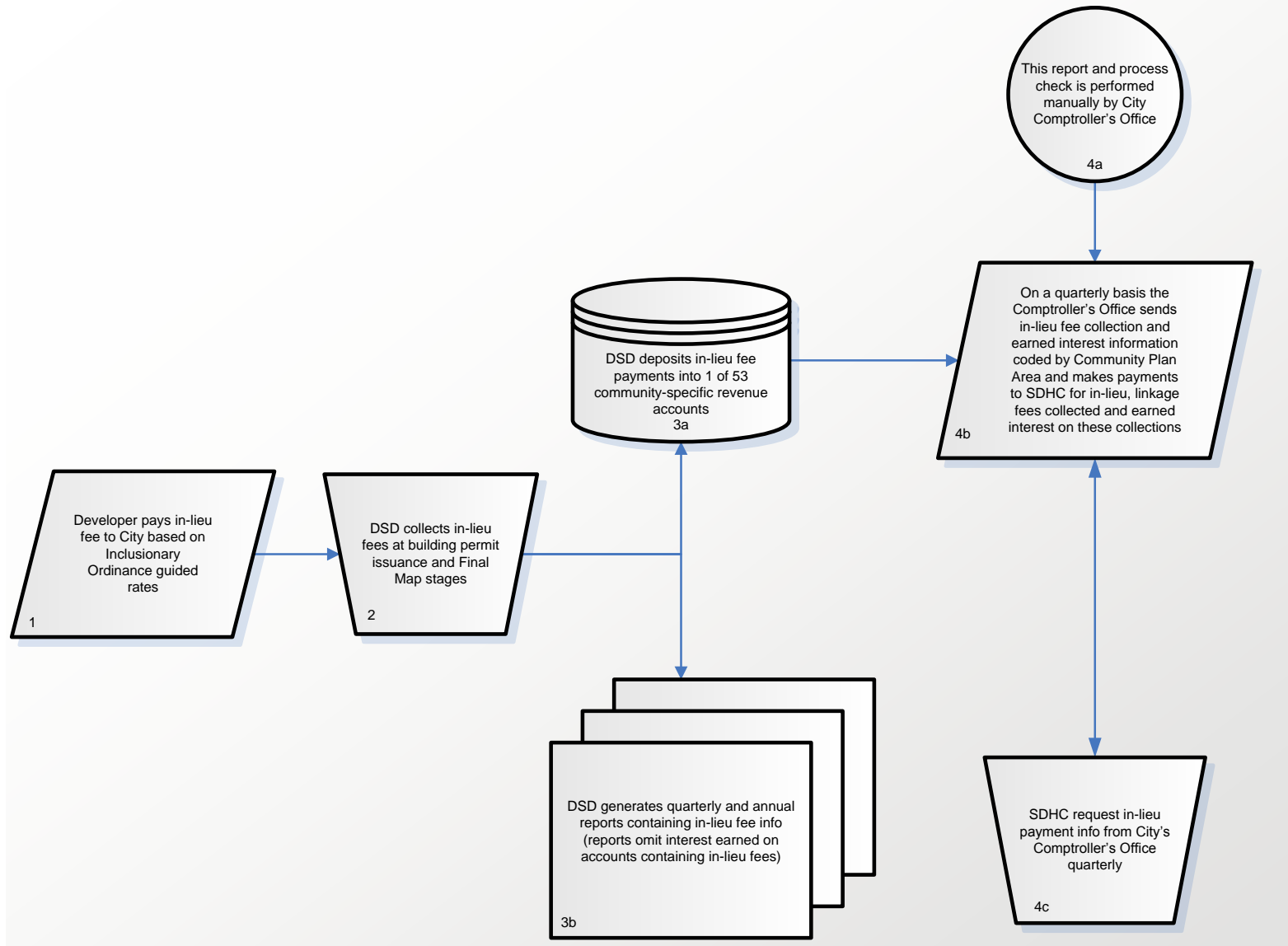


Source: Auditor generated based on conversations with City and SDHC staff.

Appendix B: Housing Trust Fund Linkage Fee Collection Process



Appendix C: Inclusionary Housing Fund In Lieu Fee Collection Process



July 23, 2009

Mr. Eduardo Luna
City Auditor
Office of the City Auditor
1010 Second Avenue, Suite 1400
San Diego, California 92101

Ref: Response to City Auditor's Report on Audit of Affordable Housing Fund

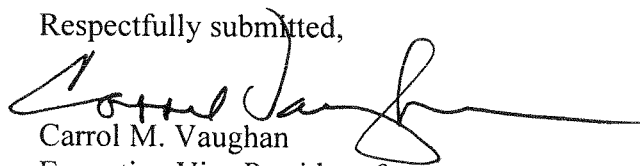
Dear Mr. Luna:

Thank you for the opportunity to provide a response to the Audit Report prepared by your office. This response will address each of the recommendations in the report as well as an estimate of when appropriate actions will be completed. We are proposing aggressive time schedules for the completion of these actions. In those cases where we will need to work with City Administration and staff, we will endeavor to meet the proposed time schedules; however, these schedules may change based on City availability to work with the Housing Commission as noted.

We would like to thank your staff, particularly John Teevan and Tiffany Chung, for their professionalism and cooperation in the performance of this audit. This report provided an opportunity for the Housing Commission to review its internal processes and procedures and to improve the administration of this important resource.

We look forward to working with your office in the future as we pursue implementation of the actions proposed.

Respectfully submitted,


Carrol M. Vaughan
Executive Vice President &
Chief Operating Officer

Cc: Richard C. Gentry, President & CEO, SDHC
Charles B. Christensen, General Counsel, SDHC
Andrea Dixon, City Attorney's Office
SDHC Vice Presidents

Response to City Auditor's Report on Audit of San Diego Housing Commission's Management and Business Practices – Part II: Affordable Housing Fund

Introduction

The Affordable Housing Fund (AHF) includes both the Housing Trust Fund revenue and revenues from the Inclusionary Housing Fund. The Housing Trust Fund (HTF) was established by the City Council in 1989 and is funded only by the commercial linkage fee. The Inclusionary Housing Ordinance was adopted by the City Council in 2003 and the in lieu housing fee is the only source of funding for the Inclusionary Housing Fund (IHF). As noted in the report, the Housing Commission was given primary responsibility for management and utilization of these important resources for the development of additional affordable housing and related services in the City of San Diego.

To date, these combined resources have produced over 18,500 units of affordable housing opportunities for San Diego residents. These opportunities include:

- 6,389 rental units
- 914 homebuyers
- 1,958 homes rehabilitated
- 9,032 transitional housing beds
- 139 pre development loans
- 9 Target of Opportunity grants
- 95 mobile home space purchases

Significant documentation is available to demonstrate that attempts have been made to clarify and update the processes and procedures regarding the Affordable Housing Fund. While some progress has been made, it is clear that a less bureaucratic process would be in the best interests of the City, the Housing Commission and the residents served by these resources.

Audit Recommendations and Responses

Housing Trust Fund Commercial Linkage Fees are Outdated and Substantially Lower than Comparable Cities

Recommendations:

- 1) SDHC, in collaboration with City Administration, should perform a review of the Housing Impact Fee schedule, and assess reasonableness and consistency with SDMC §98.0618. The fees should be updated through 2009 to be consistent with the SDMC. If the updates are not practical or feasible, the communication of the current intent to request updates through City Council should be clearly documented and retained by both the City Administration and SDHC;*
- 2) SDHC, in collaboration with City Administration, should develop and implement procedures so that Housing Impact Fee updates are recalculated March 1 of each year by the appropriate*

percentage increase or decrease as indicated in the SDMC and prepare a recommendation to the City Council for such revision on an annual basis. If the updates are not accepted or processed by the City Council, the annual communication of the requested updates through City Council should be clearly documented and retained. If the SDMC will not be followed, then it should be amended to reflect the current fee expectations in relation to the Housing Trust Fund, a change that would require City Council action to amend the SDMC;

3) City Administration should facilitate the update of the SDMC to accurately reflect the current process for the collection and maintenance of the Housing Trust Fund fees by the Comptroller in a specific subaccount after collection by the City

Responses:

1. As noted in the report, the commercial linkage fee schedule has not been updated since 1996. In June 1996 the City Council approved a recommendation from the Land Use & Housing Committee to reduce the Commercial Development Linkage Fee by 50% (beginning July 1, 1996). The discussion preceding the reduction in the fee centered around the Linkage Fee being a very strong disincentive to attracting high wage jobs into the City of San Diego.

Following the decision to reduce the fee, there was little interest in updating the fees as prescribed in the municipal code. The Housing Commission did have the nexus study updated and presented recommendations to the Land Use & Housing Committee in 2005. However, at that time it was decided to hold the recommendations until the City Council had an opportunity to address several major issues facing the City at that time. The Housing Commission did not bring this issue forward in subsequent years.

The Housing Commission will collaborate with City Administration and the City Attorney's office to review SDMC 98.0618 and determine if the Linkage Fee should be updated or if the municipal code should be revised.

2. Once it is determined if the municipal code should be revised, the Housing Commission staff will work with City Administration to develop and implement procedures so that fees are reviewed and updated in accordance with the revised municipal code. If the code will not be revised, SDHC will prepare annual fee recommendations for the City Council's consideration and will implement as approved.
3. Following City Administration's updating of the municipal code to reflect the current process to collect and maintain HTF fees, the Housing Commission will review and update internal policies, if necessary, to reflect the changes to the code.

All contact with City Administration and the City Attorney's office will be documented and retained for historical reference.

Time for Completion: June 2010

The Receipt of Direct Payments to the Housing Commission from Developers is Inconsistent with the Municipal Code

Recommendations:

- 4) SDHC personnel should immediately discontinue the practice of receiving payments directly from developers. Any future attempted payments of that type should be directed to the City DSD;*
- 5) SDHC should develop additional policy and departmental guidance to detail the process and documentation requirements in relation to the Affordable Housing Fund (inclusive of both the Housing Trust Fund and Inclusionary Housing Fund), which would include reference to the proper handling of direct payments from developers and the timely reconciliation of Affordable Housing Fund funds to include comparing City-provided periodic reporting to actual payments received on a quarterly or annual basis;*
- 6) The SDHC Policy "Commission Responsibilities Related to the Housing Trust Fund" (PO300.501) should be updated as needed to accurately reflect the current process including a prohibition against the receipt of direct payments from developers and the reporting relationship with the City, as applicable.*

Responses:

4. The Housing Commission discontinued taking receipt of payments directly from developers upon receipt of the audit report and will direct any future attempted payments to DSD. **Time for Completion: Completed**
5. & 6. Housing Commission staff will revise the current policy (PO300.501) and procedures to prohibit receipt of direct payments from developers and provide specific guidance on the handling of direct payments. The Housing Commission reconciles City reports on the fee payments on a quarterly basis. This practice will be incorporated into the policy and procedures noted above. **Time for Completion: January 2010**

The City & SDHC Report Different Amounts of Fee Revenues

Recommendation:

- 7) City Administration and SDHC personnel should reconcile the current differences in historical reported amounts for Inclusionary Housing Fund funding. If warranted, disbursement to or from SDHC or the City should be made to settle any outstanding payment discrepancies. Procedures should be established to perform this reconciliation at least annually.*

Response:

7. Housing Commission staff will work with City staff in the Comptroller's office and other appropriate City departments to reconcile the reported amounts for the Inclusionary Housing Fund. If necessary, the Housing Commission will prepare a billing to the City for amounts that have not been received by the Housing Commission.

As part of the revised procedures, the Housing Commission will request a report of payments from the City on a semi-annual basis to ensure up to date and accurate collection of these funds. **Time for Completion: January 2010**

SDHC Policies Related to the Affordable Housing Fund Need to be Improved

Recommendation:

8) *A new SDHC policy should be drafted, approved and implemented to accurately reflect the SDHC "Responsibilities Related to the Inclusionary Housing Fund" (similar to PO300.501 and including any updates thereof);*

9) *The existing policy PO300.501 (and the new Inclusionary Housing Fund policy recommended separately) should be updated to include the requirements to account for and report separately both the Inclusionary Housing Fund and the Housing Trust Fund in the audited financial statements as well as the audit for compliance with the AHF Ordinances and any related policies and regulations;*

10) *The requirements to account for and report separately both the Inclusionary Housing Fund and the Housing Trust Fund in the audited financial statements as well as the audit for compliance with the AHF Ordinances and any related policies and regulations should be implemented for the fiscal year 2009 and future annual audits.*

Responses:

8. Attached to this response is a copy of the current procedures that address the Housing Commission's responsibilities in administration of the Inclusionary Housing Fund. The policy will be reviewed and updated to include all appropriate recommendations made in this report. **Time for Completion: February 2010**

9. The Housing Commission currently accounts for the Housing Trust Fund and the Inclusionary Housing Fund separately. An audit of the Affordable Housing Fund is included with the annual audit done by the Housing Commission's independent auditor. The revisions to Policy 300.501 and the new policy to be updated for the Inclusionary Housing Fund will include a requirement to report separately in the financial statements on the Inclusionary Housing Fund and the Housing Trust Fund. **Time for Completion: February 2009**

10. The scope of the audit engagement beginning in FY2009 will be expanded to include these funds in the audited financial statements as well as a compliance audit for the AHF ordinances and policies. **Time for Completion: November 2009**

The City's Inclusionary Affordable Housing Regulations Need to be Updated

Recommendation:

11) *SDHC and City Administration should review SDMC §142.1310(e) and have the applicable SDMC sections updated to reflect the current fees or make reference to the source document or department for the updated fees, a change that would require City Council action;*

Response:

11. Housing Commission staff will work with City Administration to update the Municipal Code to reflect fee structure going forward and will include identification of the source document. This

action will require City Council action and completion will be determined by staff availability and docket scheduling. **Time for Completion: Unknown**

Controls over the Transfer of Affordable Housing Funds Can Be Improved

Recommendation:

12) City Administration should draft, approve and implement departmental guidelines (across multiple departments as needed) to accurately identify and document the process roles and responsibilities for City departments, including the Treasurer, Comptroller, Facilities Financing and Development Services Department (DSD) in Affordable Housing Fund -related processes. These processes should include the reporting of quarterly and annual Housing Trust Fund and Inclusionary Housing Fund activity by Facilities Financing and DSD to SDHC and the Comptroller. The Comptroller should reconcile fund levels and make disbursements based upon mutually agreed upon amounts from that reporting on a consistent and timely basis.

Response:

12. This recommendation refers to the City organization of the roles and responsibilities for Affordable Housing Fund activities. The Housing Commission will provide support as needed to the City to implement this recommendation. **Time for Completion: Unknown**

EXHIBIT "A"

INCLUSIONARY AFFORDABLE HOUSING IMPLEMENTATION AND MONITORING PROCEDURES MANUAL

Regulations pertaining to the City of San Diego's Inclusionary Housing Program ("Program") are incorporated in San Diego Municipal Code Chapter 14, Article 2, Division 13. The purpose of the Inclusionary Affordable Housing Implementation and Monitoring Procedures Manual ("Procedures Manual") is to provide additional detail in the implementation and administration of the Program.

Development Review Procedures

Specific development procedures are summarized in the Development Services Department Information Bulletin 532. Applicants constructing affordable units pursuant to the requirements of the Program will be eligible for expedited permit processing through the Affordable/Infill Housing and Sustainable Buildings Expedite Program as implemented by Council Policy 600-27 (See Information Bulletin 538).

Targeted Rental Households and Targeted Ownership Households

Program requirements can be fulfilled through the provision of rental or for-sale housing. Rental units meeting program requirements shall be affordable at rents affordable to households earning 65% or less of the Area Median Income ("AMI"). For-sale units meeting program requirements shall be affordable to households earning 100% AMI or less. Income restrictions shall be adjusted annually based upon the revisions to Area Median Income limits as promulgated from time to time by HCD.

Targeted Rental Household

Targeted Rental Household rent calculations shall be based on the updated AMI limits as adjusted for household size by the U.S. Department of Housing and Urban Development (HUD) for San Diego County at 65% AMI. Current rent levels as of 2008 as adjusted by household size and utility allowance are as follows:

2008 65% Area Median Income and Rent Restrictions			
Household Size	Unit Size	Income	Gross Rent*
One	Studio	\$35,950	\$899
Two	1 bedroom	\$41,100	\$1,028
Three	2 bedroom	\$46,200	\$1,155
Four	3 bedroom	\$51,350	\$1,284

*Gross rent is equal to cash rent plus all tenant-paid utilities. See the "San Diego Housing Commission Utility Allocation Schedule" to calculate the tenant-paid utilities based on the project's actual utilities mix.

The eligibility of each prospective tenant and/or household under the restrictions set forth above shall be certified by the San Diego Housing Commission. Applicants shall submit documentation for certification to the San Diego Housing Commission for a determination of tenant eligibility, prior to tenant occupancy. No Affordable Unit may be rented to a prospective tenant or occupied by any person unless and until the San Diego Housing Commission has determined that the prospective tenant or occupant has satisfied the eligibility requirements.

Targeted Ownership Household

Targeted Ownership Household price restrictions shall be based on the updated AMI limits adjusted for household size by HUD for San Diego MSA at 100% AMI. Program sales price restrictions as of 2008 are as follows:

2008 MAXIMUM INCOME 100% AREA MEDIAN INCOME

Household Size	Income
One	\$50,450
Two	\$57,700
Three	\$64,900
Four	\$72,100
Five	\$77,850

The sales price restrictions shall be established based on housing costs that do not exceed 35% of the annual median household income, including mortgage principal and interests, taxes, insurance, HOA and assessments. Purchase price assumes 5% down payment and the prevailing fixed-rate interest rates. Upon request, the San Diego Housing Commission shall prepare and make available to Applicant any general information that the San Diego Housing Commission possesses regarding income limitations, sales prices, occupancy policies and restrictions which are applicable to the affected units. Actual sales prices for units restricted at 100% AMI will be calculated on a project-by-project basis.

The eligibility of each prospective buyer and the sales price under the restrictions set forth above shall be certified by the San Diego Housing Commission. Applicants shall submit documentation for certification to the San Diego Housing Commission for a determination of buyer eligibility prior to close of Escrow on each restricted unit. Affordable Units must be owner occupied unless the San Diego Housing Commission has determined a hardship on a case-by-case basis. Except where authorized by the San Diego Housing Commission for a specific unit, renting a restricted unit would trigger a recapture in equity pursuant to San Diego Municipal Code Section 142.1309 (e).

Exemption of Naturally Affordable For-Sale Units

Pursuant to Section 143.1303 of the Municipal Code, any portion of a residential development project that meets all of the following criteria shall be exempted from the requirements of the Program, including payment of the in-lieu fee:

- The units contained within the residential development project are for-sale to private household(s), who owns no other real property, for use as the buyer's primary residence;
- The units are specifically targeted for, sold to, and occupied by households earning less than 150% AMI; and
- Each qualifying unit must have two (2) or more bedrooms (not required for condo conversions).

The unit(s) subject to this exemption has recorded against it an agreement between the *Applicant* and the Chief Executive Officer of the San Diego Housing Commission assuring that the provisions above have been met. The San Diego Housing Commission will certify the eligibility of the prospective buyers.

In the event that the Applicant is unable to fulfill the requirements of this provision, the Program requirements will be applied to the units that would have been exempted. The Applicant may choose to pay the then-current, applicable in-lieu fee or provide the affordable units as provided for in the Inclusionary Housing Ordinance.

Qualifying 150% units shall be sold at prices at or below the "Maximum Sales Price". The Maximum Sales Price shall be the sales price determined and published by the San Diego Housing Commission on an annual basis to be the Maximum Sales Price for a unit affordable to a household with income at 150% AMI, adjusted for unit size, based upon the number of bedrooms located within the 150% Unit(s). The Maximum Sales Price shall be determined by the San Diego Housing Commission in its reasonable discretion as the amount which will result in an annual housing cost to the purchaser of the 150% Unit, which does not exceed the thirty-five percent (35%) of one hundred fifty percent (150%) of Area Median Income adjusted for household size, determined as of the date of the execution of a binding purchase and sale agreement for the 150% Unit and shall include, without limitation, mortgage principal and interest, taxes, insurance, HOA and assessments.

Maximum eligible incomes and Maximum Sales Price restrictions shall be adjusted based upon the revisions to Area Median Income limits as promulgated from time to time by HUD.

All units qualifying for this exemption for the year 2008 shall be affordable at or below the maximum sales prices shown in the chart below.

**2008 SALES PRICE RESTRICTIONS
150% AREA MEDIAN INCOME**

Unit Size (bedrooms)	Maximum Sales Price
Studio	\$269,822
One	\$305,568
Two	\$341,623
Three	\$381,228
Four	\$412,140

The maximum eligible incomes for 2008 are as follows:

**2008 MAXIMUM INCOME
150% AREA MEDIAN INCOME**

Household Size	Income
One	\$75,675
Two	\$86,550
Three	\$97,350
Four	\$108,150
Five	\$116,775

Condominium Conversions

Pursuant to Section 143.1306 of the Municipal Code, condominium conversion units affordable to and sold to households earning less than 150% AMI shall be exempted from the requirements of the Program, including payment of the in-lieu fee. Qualifying units shall be sold to private household(s), who owns no other real property, for use as a primary residence.

Applicants with qualifying condominium conversion units ("150% units") as described above shall be allowed to self-certify that units meet the required affordability level and eligibility of buyers.

Compliance with the exemption from the provisions of the Inclusionary Housing Ordinance shall be determined at the time of the execution of the purchase and sale agreement, when the purchase price is fixed. Applicants shall enter into an agreement with the San Diego Housing Commission to ensure compliance.

The San Diego Housing Commission may, but shall not be obligated to, perform the following monitoring functions and services, on a periodic basis: (A) reviewing the applications of prospective or actual occupants and/or purchasers of the affected units, to spot check the eligibility of such persons and/or households as eligible occupants and/or households; (B) reviewing the documentation submitted by Applicants in connection with the certification process for eligible households and/or occupants. Notwithstanding the foregoing description of the San Diego Housing Commission's functions, no person or entity, including the Applicant shall have any claim or right of action against the San Diego Housing Commission based on any alleged failure to perform such function, except that Applicant may reasonably rely upon the San Diego Housing Commission's tenant eligibility determination and the Applicant shall not be liable to the San Diego Housing Commission for any damages, attributable to the San Diego Housing Commission's sole negligence or willful misconduct in conducting any eligibility determinations and/or monitoring.)

Off-Site Housing

If the Applicant elects, pursuant to Section 142.1306 (b)(2) of the San Diego Municipal Code, to construct Off-Site Units to satisfy the requirements of this Program, the Applicant shall construct the Units within the same Community Planning Area, as delineated in the General Plan of the City of San Diego, as the Principal Project. An alternate site for the construction of the Affordable Units shall be subject to the advance written approval of the Planning Director of the City of San Diego and the Chief Executive Officer of the San Diego Housing Commission or the Redevelopment Agency and the Chief Executive Officer of the San Diego Housing Commission, in the event the Affordable Development Project is located in a Redevelopment Project Area.

An Applicant may satisfy the requirements of this Program by the use of Affordable Units constructed by other developers, in addition to any to be built to meet their respective affordable housing requirements as set forth in the Ordinance, by transfer of credits between developers, if and when approved by the Planning Director of the City of San Diego and the CEO of the San Diego Housing Commission. The Receiver Applicant would be precluded from utilizing any local public funds to meet the Program's affordability requirements. The approval of the Receiver Site would be subject to all applicable approvals set forth in this Procedures Manual and the Ordinance.

If the Applicant elects, pursuant to Section 142.1306 (b)(3) of the San Diego Municipal Code, to construct the affordable units on a site different from the primary development site and outside the community planning area, the applicant must obtain a variance in accordance with Section 142.1304 in accordance with Process Four. An alternate site for the construction of the Affordable Units shall be subject to the advance written approval of the Planning Director of the City of San Diego and the Chief Executive Officer of the San Diego Housing Commission or the Redevelopment Agency and the Chief Executive Officer of the San Diego Housing Commission, in the event the Affordable Residential Development Project is located in a Redevelopment Project Area. The use of an alternate site for the construction of the Affordable Units outside of the Community Planning Area of the Principal Project must be found to support the community and economic balance and/or transit orientation goals.

Alternative Development Schedule and Phasing of Units

Pursuant to San Diego Municipal Code Section 142.1309(a)(1), an Applicant may seek approval for an alternative development schedule subject to a Process Two approval. An Applicant approved for an alternative development schedule may provide Affordable Units in accordance with the following:

Affordable Units built subject to this Program shall be constructed, completed, and ready for occupancy no later than the date that the Market Rate Housing is constructed, completed and ready for occupancy unless there is an otherwise acceptable agreement for an alternative development schedule which is satisfactory to the CEO of the Housing Commission or the CEO of the San Diego Housing Commission and the Redevelopment Agency in the event that the Principal Project is located within a Redevelopment Project Area.

The timely construction of the affordable housing shall be assured by the posting of a bond and the execution of agreements satisfactory to the CEO of the San Diego Housing Commission on or before the issuance of the first building permit for any unit in the Residential Development Project.

In the event that the development is proposed to be constructed in phases or the affordable housing is proposed to be constructed off-site, an alternative development schedule may be approved, subject to a written agreement between the Applicant and the CEO of the San Diego Housing Commission, such as the following:

The issuance of building permit for the Affordable Housing Project shall occur on or before the earlier of: (i) the issuance of building permits for construction of the number which represents 50% of the Market Rate Units within the Project; or (ii) the date which is eighteen (18) months after the filing of final map for the Market Rate Project, or (iii) a date which is eighteen months after the receipt of the building permit for the first Market Rate Unit if no final map is filed;

Completion of construction of the Affordable Housing Project shall occur upon the earlier of twelve (12) months after the issuance of building permits for the Affordable Housing Project as described above; or the date which is two and one-half years after the earliest date determined above.

The issuance of building permits for the construction of the number which represents 75% of market rate units for the Project shall not occur until the completion of all of the Affordable Units is authorized by the City.

Occupancy of the Affordable Housing Project by persons meeting the Program Eligibility requirements shall occur not later than 180 days after the completion of construction as determined above.

In-Lieu Fees

Pursuant to Section 143.1310, an Applicant may pay a fee in lieu of constructing affordable units.

Where no building permit application is filed in connection with a condominium conversion project, the in-lieu fees shall be paid in full no later than the close of escrow of the first unit sold within the project, subject to an agreement with the San Diego Housing Commission. The Applicant shall pay the then current, applicable in-lieu fee amount

The amount of the in lieu fees to be charged and collected for each Residential Development Project shall be the product of the applicable per square foot charge multiplied by the aggregate gross floor area, as defined in the San Diego Municipal Code, of all of the units within the Residential Development Project (excluding garages and carports).

The following In Lieu Fees shall be collected during the first three (3) years after the Program is effective:

PROJECTS OF 10 OR MORE UNITS	
YEAR ONE	\$1.00/ SQ. FOOT
YEAR TWO	\$1.75/SQ. FOOT
YEAR THREE	\$2.50/SQ FOOT

PROJECTS OF LESS THAN 10 UNITS	
YEAR ONE	\$0.50/SQ FOOT
YEAR TWO	\$0.875/SQ FOOT
YEAR THREE	\$1.25/SQ FOOT

The level of the in-lieu fee shall be revised annually commencing on the fourth year based on the following formula:

- Fifty percent of the difference between the median sales price of all homes sales in the City of San Diego for the last quarter of the year prior to the time of adjustment (as established by an independent and reputable real estate data firm that publishes data on no less than a quarterly basis) and the amount of money a median-income family of four is able to afford to purchase a home.
- The product of the above calculation shall then be divided by 10, in order to represent the level of obligation under the Program.
- The product of the above calculation shall then be divided by 2,000 Square Feet which represents the average size (Square Feet) of a unit constructed within the City of San Diego, in order to determine the level of the in-lieu fee for projects of ten or more units. Average size of a unit may be adjusted from time to time.
- The level of the in-lieu fee for projects of less than 10 units shall be 50% of the amount set for projects of 10 or more units.

Example:

Assume that the median income household can afford to purchase a home priced at \$174,000. The median home price within the City of San Diego is \$274,000. Fifty percent of the difference between the median home price and that which the median income household can afford is \$50,000. Ten percent of this number is \$5,000. This number is divided by 2,000 SF to produce an in-lieu fee level of \$2.50 per square foot for projects of 10 or more. The level of the in-lieu fee for projects of less than 10 units would be 50% of this or \$1.25 per square foot.

Pursuant to the above formula, the in-lieu fee from July 3, 2008 to July 2, 2008 is \$6.31/square foot for projects with 10 or more units and \$3.16 for projects with 9 or fewer units.

Determining Amount of In Lieu Fee(s)

The San Diego Municipal Code Section 142.1310(a), provides “the rate of the in lieu fee shall be determined at the time the building permit application is filed”. Therefore, at the time the building permit application is filed, Development Services shall determine the amount of the in lieu fee and will advise the applicant of the amount of the applicable in lieu fee, in accordance with the following:

- (1) For building permits that are obtained within three (3) years of the date that the subject application for the first tentative map or development permit was deemed complete, the rate of the in lieu fee shall be the rate in effect at the time the application for that first tentative map or development permit was deemed completed.
- (2) For building permits that are not obtained within three (3) years of the date that the subject application for the first tentative map or development permit was deemed complete, but are issued within three (3) years of the date of approval of the first tentative map or development permit, the rate of the in lieu fee shall be the rate in effect at the time that first tentative map or development permit was approved.
- (3) For building permits that are not obtained within three (3) years of the date that the subject application for the first tentative map or development permit was deemed complete, and that are not issued within three (3) years of the date of the approval of the first tentative map or development permit, the rate of the in lieu fee shall be the rate in effect at the time the application for the building permit is deemed complete.
- (4) For any tentative map or development permit approved on or before July 3, 2006, that contains a condition to pay the inclusionary housing in lieu fees, the rate of the in lieu fee at building permit issuance shall be fixed at not more than \$1.25 per square foot for projects of nine (9) or less residential units or \$2.50 per square foot for projects of ten (10) or more residential units for a period of three (3) years from the date the tentative map or development permit was approved, or until July 3, 2006, whichever occurs later. The rate of the in lieu fee thereafter shall be the rate in effect at the time the application for the building permit is deemed complete.

Conversion of Tenure Type for Affordable Units

Any Affordable Units constructed pursuant to the Program, proposed to change the type of tenure from rental to for-sale or for-sale to rental must satisfy the requirements of this Procedures Manual.

Any Affordable Rental Units to be converted to ownership units must satisfy the requirements of this Procedures Manual. Any Rental Units to be converted to For-Sale Units shall be sold at or below the Maximum Purchase Price to Targeted Ownership Households meeting the income qualifications specified in the Notice of Affordable Restrictions or conditions of approval, with a right of first refusal for the occupant(s) of such Units at the time of conversion. All provisions of the Program at the time of said conversion shall apply to the conversion of the Unit, including sales price and length and method of restriction.

Any Affordable Ownership Units to be converted to rental units must satisfy the requirements of this Procedures Manual. Any Affordable Ownership Units to be converted to Rental Units shall be rented at or below the Maximum Rental Rate to Targeted Rental Households meeting the income qualifications specified in the Notice of Affordable Restrictions or conditions of approval. All provisions of the Program at the time of said conversion shall apply to the conversion of the Unit, including rental rate and length and method of restriction.

Affirmative Marketing Requirements

The conditions of approval shall specify that Applicant shall adhere to the marketing, monitoring, and enforcement procedures outlined in this section. Affirmative marketing steps consist of actions to provide information and otherwise attract eligible persons in the housing market area to the available housing without regard to race, color, national origin, sex, religion, familial status or disability. Applicants shall comply with the terms of their approved affirmative marketing plan, as may be amended from time to time, consistent with City Council Policy 600-20 and Fair Housing Law. The requirements of the affirmative marketing program shall be binding on the original Applicant's successors in interest to the extent that the first sales to the general public are covered.

Ongoing Monitoring

An initial monitoring fee of \$500 will be assessed as a one-time charge to cover costs for developing the compliance monitoring plan, computer database program and reporting system for the project, and training sessions for owner/manager. This fee is only applicable to rental properties.

Annual Monitoring will be required for all rental affordable units developed under the Program. The base monitoring fee per unit is \$65 for the first 40 units. The base fee charged decreases \$10 for each unit more than 40 units, and decreases \$20 for each unit more than 80 units.

1 to 40 Units \$65 per unit

41 to 80 Units \$55 per unit

81+ Units \$45 per unit

The Annual Monitoring fee shall be adjusted upward annually for increased costs due to inflation. The adjustment shall reflect the change in the Consumer Price Index for all Urban Consumers (CPI-U) for the County of San Diego.

For projects that contain affordable for-sale units, a \$1,000 per unit fee will be required for monitoring and determining eligibility for price restricted units. The fee is due upon execution of a cooperation agreement between the Applicant and the Housing Commission.

Waivers, Adjustments and/or Reductions

The City Council of the City of San Diego desires to clarify the procedures that allow potential lack of nexus challenges to the constitutionality of the Inclusionary Ordinance under the provisions of San Diego Municipal Code Section 142.1305. The Council declares that this amendment to the Procedures Manual is declaratory of its existing intent and policy and remedies that exist under the current ordinance and under state law. This Procedures Manual was adopted by Resolution Number R-298003, adopted on May 20, 2003, and may be updated, revised and/or clarified by resolution.

An applicant for or developer of any development, project or property subject to the requirements of the Inclusionary Ordinance may appeal for a reduction, adjustment or waiver of the requirements of the Inclusionary Ordinance by following the procedures outlined in Section 142.1304 and/or 142.1305, based upon the absence of any reasonable relationship or nexus between the impact of the development and either the amount of the in lieu fee or the inclusionary housing requirement. If such lack of nexus is established under either Section 142.1304(d)(1) (variance) and/or 142.1305(d)(1) (waiver), then the findings required under 142.1304(d)(2), (3) and (4) for a variance and/or Section 142.1305(d)(2), (3) and (4) for a waiver, shall automatically be deemed established by the decision makers.

It is the intent of this policy to be applicable until the City Council amends the Inclusionary Ordinance to reflect this policy concerning reduction, adjustment and waivers.

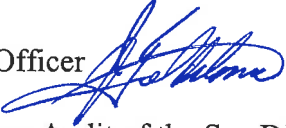


THE CITY OF SAN DIEGO

M E M O R A N D U M

DATE: July 28, 2009

TO: Eduardo Luna, City Auditor

FROM: Jay M. Goldstone, Chief Operating Officer 

SUBJECT: Response to Part II of the Performance Audit of the San Diego Housing Commission

This memorandum responds to the recommendations for City departments that were included in Part II of the June and July 2009 Performance Audit of the San Diego Housing Commission. The San Diego Housing Commission is responding separately to the recommendations directed to their organization.

Executive Summary, Page 2 – SDHC Inclusionary Housing Fund Policies and Regulations are Inadequate or Poorly Defined.

Response: Although DSD does not disagree with this finding, please note that DSD refers to the following publications for policy and regulation direction. All of these publications are available to the public and staff on the City's website:

1. Municipal Code Section 142.1300 – The Inclusionary Housing Ordinance;
2. DSD's Information Bulletin 532 – Summary of the Inclusionary Ordinance;
3. The Inclusionary Affordable Housing Implementation and Monitoring Procedures Manual-Published by the Housing Commission.

Executive Summary, Page 2 – The City's Inclusionary Affordable Housing Regulations need to be updated.

Response: Although DSD does not disagree with this finding, please note that DSD believes that adequate and complete information regarding in-lieu fees is readily available to the public in the form of Information Bulletin 532. The purpose of DSD's Information Bulletin system is to provide an easy-to-understand, simple explanation of the innumerable and often-times complex domain of building codes and regulations. As a result, the information provided within the

Bulletins has shown to be more readily available, easier to understand, and more efficiently updated than are the actual Municipal Code sections from which they are derived. In terms of updates to the in-lieu fees, Information Bulletin 532 is updated each year in July. DSD believes that the current Information Bulletin system provides adequate information to the public, and that updating the Inclusionary Housing Ordinance each year to reflect the updated fees would be an inefficient use of staff time and the public hearing process.

Housing Trust Fund Commercial Linkage Fee, Page 9 – “As it relates to the City Engineer’s role in providing HTF fee adjustment consultation to SDHC, we found that the City’s Development Service Department does not coordinate with SDHC to adjust HTF fees based on the building cost “Index of the Cost Indices for Twenty Cities” published by M.C. McGraw–Hill, Inc. as directed by the SDMC.”

Response: The Development Services Department’s role and responsibility as it pertains to the Housing Trust Fund (as well as the Inclusionary Housing In-lieu fee) is limited only to the actual collection of those fees at the time building permits are issued. Neither the City Engineer nor the Development Services Department is involved in coordinating with the Housing Commission to adjust those fees.

Although the entire Municipal Code section referred to in the Auditor’s Report (Chapter 9, Article 8, Division 6 – Housing Impact Fees on Commercial Development) indicates that the City Engineer is fundamentally involved in the Housing Trust Fund adjustment process, this is not the case. Therefore, Development Services Department recommends that the San Diego Housing Commission amend this Chapter of the Municipal Code to describe the actual process as it exists, and to delete any reference to the City Engineer’s role in the fee adjustment process.

Recommendation #3, Page 12

City Administration should facilitate the update of the SDMC to accurately reflect the current process for the collection and maintenance of the Housing Trust Fund fees by the Comptroller in a specific subaccount after collection by the City.

Response: Management agrees with the recommendation. City Administration will work with SDHC to accurately reflect the process for collection and maintenance of the Housing Trust Fund fees and review and update, if necessary, the San Diego Municipal Code (SDMC) for accuracy in terms of authority and process clarity. We will produce a process procedure aligned with the new OneSD coding structure to detail the transaction accounting of the Housing Trust Fund fees and the individual responsibilities for collecting, maintaining, dispositioning and reconciling these fees and accounts. This work will be completed by the end of October 2009.

Recommendation #7, Page 15

City Administration and SDHC personnel should reconcile the current differences in historical reported amounts for Inclusionary Housing Fund funding. If warranted, disbursement to or from SDHC or the City should be made to settle any outstanding payment discrepancies. Procedures should be established to perform this reconciliation at least annually.

Response: Management agrees with the recommendation. City Administration will reconcile its records with SDHC records in regards to current differences in historical reported amounts for Inclusionary Housing Fund (IHF) funding. Any discrepancies will be settled into the proper accounts on either the City's books or SDHC's books. A process procedure for regular (at least annually) reconciliation of the IHF funding between the City and SDHC will be developed to ensure that the accounts are properly balanced. This work will be completed by the end of September 2009.

Recommendation #11, Page 17

SDHC and City Administration should review SDMC § 142.1310(e) and have the applicable SDMC sections updated to reflect the current fees or make reference to the source document or department for the updated fees, a change that would require City Council action.

Response: Although DSD does not disagree with this finding, please note that DSD believes that adequate and complete information regarding in-lieu fees is readily available to the public in the form of Information Bulletin 532. The purpose of DSD's Information Bulletin system is to provide an easy-to-understand, simple explanation of the innumerable and often-times complex domain of building codes and regulations. As a result, the information provided within the Bulletins has shown to be more readily available, easier to understand, and more efficiently updated than are the actual Municipal Code sections from which they are derived. In terms of updates to the in-lieu fees, Information Bulletin 532 is updated each year in July. DSD believes that the current Information Bulletin system provides adequate information to the public, and that updating the Inclusionary Housing Ordinance each year to reflect the updated fees would be an inefficient use of staff time and the public hearing process.

Recommendation #12, Page 19

City Administration should draft, approve and implement departmental guidelines (across multiple departments as needed) to accurately identify and document the process roles and responsibilities for City departments, including the Treasurer, Comptroller, Facilities Financing and Development Services Department (DSD) in Affordable Housing Fund-related processes. These processes should include the reporting of quarterly and annual Housing Trust Fund and Inclusionary Housing Fund activity by Facilities Financing and DSD to SDHC and the Comptroller. The Comptroller should reconcile fund levels and make disbursements based upon mutually agreed upon amounts from that reporting on a consistent and timely basis.

Response: Management agrees with the recommendation. City Administration will develop one or a series of process flow procedures to ensure that all City departments and the SDHC are coordinated with the collection, disposition, reconciliation, and reporting of Housing Trust Fund and Inclusionary Housing Fund activity. City Administration will also ensure that all required payments to SDHC are done on time and according to a payment schedule agreed to by the City and SDHC. These procedures will be written and in place by the end of November 2009.

cc: Honorable Mayor Jerry Sanders